

EXPLORE FINANCE TECHNIQUES FOR PROJECTS IN AFRICA

by Paula Mitchell

Office of Finance, Trade Development

African markets present considerable trade and investments opportunities for U.S. firms because of their abundance of natural resources and their overall economic growth potential. Yet these are also difficult financial markets because of historical political and economic risks. Most U.S. firms interested in investing or trading within Africa have had difficulties in accessing private sector finance and will, in all likelihood, find it necessary for many years to rely on creative finance arrangements. A number of alternative financing techniques are used with varying degrees of success to ameliorate finance-related problems. Some of these include:

COUNTERTRADE: In its simplest form, countertrade involves the contractually linked reciprocal import/export transactions between two enterprises in two countries. The structure of countertrade transactions varies according to the characteristics of the deals financed and the types of assets that form the means of repayment.

Given its export base of commodities and raw materials, there is a huge but unfulfilled potential for countertrade in Africa. The small volume of countertrade transactions can be explained by the fact that commodities and raw materials represent traditional cash exports, so that countries find few tangible benefits in countertrading commodities needed

to generate hard currency or sustain the country's balances of payments and which, in the hands of some brokers, may end up competing with the countries' own exports. A major drawback of countertrade deals involving commodities of sub-Saharan Africa is the reluctance of commercial banks to participate in the deals. Additionally, banks may not want to take countertrade-related risks, such as those associated with the performance of the African importer or warehousing risk. However, commodity-backed transactions as part of short-term structured finance arrangements still remain an option in financing trade with the region.

FINANCE LEASING: Typically, a finance lease is a full-payout, irrevocable agreement in which the lessee is responsible for maintenance, taxes, and insurance. Finance leasing has proven an appropriate and financially successful way of supporting firms in lower per capita income regions, such as sub-Saharan Africa. Leasing activities have intensified as governments have recognized the importance of leasing. Investment Banking & Trust Company, a leading regional merchant bank for Cadbury Nigeria, which was investing in a new mint production line, arranged a major lease in sub-Saharan Africa in 1995. Leasing transactions have also been financed in Zimbabwe, Botswana, Malawi, Ghana, Senegal, Benin, Tanzania, Uganda and Ivory Coast. Major providers of leasing services are AT&T Capital Corporation, GE Capital Corporation, Bank of America, Standard Chartered Bank,

Barclays Bank, Credit Suisse and Merchant Bank.

ESCROW ACCOUNT: The purpose of an escrow account is to provide a mechanism to insulate export revenues and disburse to lenders, according to contractual terms, the hard currency revenues generated by the project, which is being financed by a loan. The use of an escrow account in sub-Saharan Africa, usually established offshore, may be appropriate: (a) when a loan is being advanced on a project finance basis; (b) to support trade payments to a non-African contractor who has entered into a contract with an African company; (c) for pre-export financing by a non-African lender; and (d) as a collateral for equity investments by a non-African investor. For the above escrow account mechanisms, prior approval from the country's Central Bank may be necessary.

PROJECT FINANCE: Project finance is a technique for funding projects that require commitments of large sums and protracted debt servicing. In project finance, lenders look to the project's cash flow to repay the debt and to the project's assets for security. Project finance packages require tailoring the ratio of the lender's debt and the sponsor's equity so the income earned by the completed project is adequate to service the debt and may involve complex finance structures to hedge risk. An example of such a complex project finance deal was the financing in 1992 of the Ashanti Goldfield in Ghana by the World Bank's International Finance

Corporation (IFC). The IFC underwrote a \$350 million investment in the Ashanti Goldfield Corporation, which included a gold hedging facility with the IFC as the swap manager. Loan service payments were serviced by the project's cash flows.

FACTORING FINANCING: Factoring is a financing technique that relies on discounting of short- and medium-term trade debts. The factor assumes responsibility for the credit, collections, and record-keeping functions for the supplier client. Factoring in sub-Saharan Africa is found only in the manufacturing and trading sectors. It is available from specialized divisions of major commercial banks. The leading companies that provide factoring financing are Standard Bank Factors, Nedbank Factors, RSA Factors, Capital Bancorp, Summit Finance, Ventures and Trust Limited, and First Industrial. Factoring houses provide the complete service of sales-ledger accounting and credit decision-making. Only Standard Bank Factors will accept bad-debt risk, the other factoring houses insist on recourse to the customer.

The Financial Services and Countertrade Division (FSCD), part of the Office of Finance of the International Trade Administration, is staffed with experts in the finance-related areas mentioned above. FSCD advisory services are available to all U.S. firms and individuals and are most helpful during the initial phase of a transaction or when firms develop their marketing plan.

AFRICA: FINANCIAL SECTORS

Africa has always been seen as a difficult financial market because of the region's political and economic problems. Today, however, market liberalization is making the continent increasingly attractive to foreign traders and investors.

Many African countries have democratically elected governments. Africa has also made slow but steady progress

in liberalizing its markets by introducing market-oriented reforms, entering into regional cooperation agreements that facilitate trade, and taking steps toward currency convertibility. Many countries have implemented reforms that promote private sector financial institutions. Nevertheless, the financial sectors are still underdeveloped and reforms of the financial sectors are marked by a decade of macro financial instability due to seemingly insurmountable macroeconomic and political barriers in reforming the financial sectors of some countries. For sustainable economic growth, it is essential that reform be continued and that countries address key constraints to a healthy financial sector development. In fact, countries that have been most successful at restructuring their financial sectors have sustained economic growth and increased inflows of foreign investments.

The region's financial infrastructure can be broken down into three categories: banks, stock market, and the insurance sector.

BANKING. Banking is the building backbone of the continent's economic development. Most African countries feature considerable concentration in the banking sector, but offer few products. Moreover, the capitalization of banks and non-bank financial institutions is poor, rendering these institutions highly leveraged. Africa's banking sector is relatively small in terms of the markets' GDPs.

STOCK MARKET. The sub-Saharan region has the least developed and fewest numbers of stock markets than other developing regions. Only about nine countries have established stock exchanges. The stock exchanges in Africa had a combined market capitalization at the end of 1995 of just over \$265 billion. The Johannesburg Stock Exchange in South African was the most important market accounting for \$240 billion followed by \$9.2 billion in the rest of the sub-Saharan Africa in

the countries of Botswana, Ghana, Ivory Coast, Kenya, Namibia, Nigeria, Swaziland, Zambia, and Zimbabwe. North Africa's Egypt, Tunisia, and Morocco stock markets accounted for around \$14.5 billion while the stock exchange of Mauritius accounted for a further \$1.7 billion.

INSURANCE. Economic and regulatory problems have contributed to the poor standing of this sector. Improved economic conditions and reforms have to be established to open this sector and make the continent more attractive to foreign investments. Most of the insurance sector is still controlled by the government and foreign firms. Foreign investments and ownership in this sector is restricted in most countries. South Africa, which developed its insurance industry early, is open to foreign investors and has the most developed sector on the continent. The African Insurance Organization, a non-governmental entity recognized by many African governments aims to promote and develop health insurance and reinsurance industry in the continent. In January 2001, the Common Market for Eastern and Southern Africa (COMESA), an organization of member states established the African Trade Insurance Agency (ATI), which will assist exporters and importers gain access to political risk insurance for trade developments. While there are currently only seven member of ATI, namely Malawi, Kenya, Uganda, Burundi, Zambia, Rwanda and Tanzania, membership is open to all members of the organization of African Unity.

The U.S. Department of Commerce's International Trade Administration recently released a valuable reference tool outlining Africa's financial infrastructure. The text is entitled "Africa: Financial Sectors."

FOR MORE INFORMATION

Contact Paula Mitchell at the Office of Finance at 202-482-4471, or Email: Paula_Mitchell@ita.doc.gov